

9 Development projects and their management

9.1. In this chapter we consider BWB's management and control procedures for development projects. We report on three case studies and a further two more limited reviews which we have undertaken of development projects on BWB land.

Management of investment portfolio

Background

9.2. In 1984 BWB agreed with the DoE a Statement of Objectives (see Appendix 2.2), which included: 'opportunities to expand and develop profitable activities (in conjunction with the private sector where possible) should be pursued in ways which would increase the Board's resources'. The IBS, described in Chapter 3, states that additional funds generated are invested in high return projects to give future revenue streams, reduce operating costs and improve waterway standards. This new approach is epitomized in BWB's Mission Statement: 'We seek to expand business on the waterways by pursuing a commercial approach providing a safe and high quality environment for customers, staff and local communities and aiming for excellence in every aspect of our work'.

9.3. Where a development takes place on a site owned by BWB, the usual procedure is for BWB to market the site and obtain best value through either sale or lease. BWB usually acts as facilitating landlord and owner. BWB ensures that it is now the developer who assumes most of the commercial risks.

Development of the portfolio

9.4. Development potential of BWB land is monitored by headquarters, the regions and waterway offices together with an independent review by property consultants. BWB normally instructs a major firm of commercial surveyors to advise on the potential development of its major sites. Planning consultants are also normally retained on major sites to obtain the highest value consent prior to disposal which may be in some instances by way of joint venture development. Many sites are environmentally sensitive or 'heritage' sites, and this has to be taken into account. BWB and its independent adviser use the standard development appraisal techniques (including cash flows, gross yields, internal rates of return, and sensitivity analyses) used by the private sector. BWB advised us that post-development analyses are carried out, but emphasized that when promoting the development and disposal of its property assets it not only has regard to normal property considerations and the requirement to achieve best value, but also to special waterway considerations such as operational requirements (sluices, culverts etc), access, landscaping, safety, conservation and heritage value.

9.5. BWB is not a statutory consultee in the planning process. Whereas its information network and local knowledge normally brings to its attention planning applications on land adjoining its ownership, this cannot be guaranteed and any observations made to the relevant planning authority do not have to be heeded.

9.6. BWB acts as facilitating landlord and owner for the vast majority of developments on its land, and development is normally preferred to outright disposal. Whereas in the past BWB occasionally set up joint

venture companies, it is constrained by Government rules in its exposure to development risk: 49 per cent of a joint venture is the maximum exposure permitted. Accordingly BWB is unable to secure the whole of the development profit but any development losses are also limited. In any event BWB advised us that it did not now generally seek joint venture company agreements.

9.7. BWB is sensitive to the impact development or disposal may have on retained and operational holdings. It is very aware of the joint venture routes open to it. Current policy is to enter into a development agreement with a financially strong partner, structured so that BWB only disposes of a major interest in land when development obligations have been completed.

9.8. Normally BWB can secure some benefits for the waterways such as improved canal walls, additional landscaping or perhaps new moorings when development occurs on land adjoining the waterway, while others benefit from enhanced property values due to the presence of the water. This may not be the case, however, if BWB does not own any land involved in the development. BWB is not permitted to invest in land acquisitions adjoining remainder waterways, and it told us that this sometimes restricts its development activities.

Investment property returns

9.9. We have compared the gross yields generated by the BWB non-operational property investment portfolio over the last three financial years with a comparative index prepared by Investment Property Databank (IPD) which is commonly accepted by the private sector as the principal commercial property data source. The results are set out in the following table.

TABLE 9.1 BWB operational asset values, rental income and yields, 1990/91 to 1992/93

	1990/91	1991/92	1992/93
Book asset value (£'000)	167,499	158,022	154,181
Rental income (£'000)	10,991	11,627	12,939
Yield (%)	6.56	7.36	8.39
IPD income returns (%)	6.05	7.33	8.15

Source: BWB and IPD (adjusted to financial years).

9.10. Numbers are not currently available to differentiate yields between investment properties to be held on a continuing basis, and those earmarked for early disposal. The IPD figures relate to calendar years 1990, 1991 and 1992 and are based upon a sample of commercial investment property currently valued at £34.0 billion, comprising 41.6 per cent retail, 43.8 per cent offices and 14.6 per cent industrial; they have been adjusted to a financial year basis. The bench-mark is not therefore strictly comparable but serves as a good indicator. At April 1993 the index stood at 8.60 per cent but based on a considerably smaller sample.

9.11. Staff costs related to the management of the investment portfolio are estimated at £1,327,000 per annum (excluding accommodation costs), thus reducing the current gross rental income from the portfolio of £12,939,000 a year to a net figure of £11,612,000 a year. The overall gross yield is thereby reduced from 8.4 per cent gross to 7.5 per cent net. It should be noted, however, that the IPD statistics do not allow for such adjustments and the comparable figure measures yields on a gross basis.

9.12. Proceeds from disposal of non-operational property are used to fund investment in the operational and non-operational estate. The amount of money available for investment in either estate is clearly dependent upon the level of disposals in any one financial year, although the numbers do not match exactly (Table 9.2).

TABLE 9.2 **BWB investment in property and value of property disposals, 1990/91 to 1992/93**

	£'000		
	1990/91	1991/92	1992/93
Non-operational estate	1,390	1,253	3,542
Operational estate	<u>2,590</u>	<u>6,654</u>	<u>3,206</u>
Total	<u>3,980</u>	<u>7,907</u>	<u>6,748</u>
Property disposals	3,947	8,643	5,872

Source: BWB.

9.13. The pace of the investment programme appears to be driven by the ability to dispose of properties rather than vice versa, and the level of disposals is set by the annual business plan. There is competition from the regions for the allocation of investment funding and at any one time BWB has more investment schemes worthy of support than funds available. Allocation of funds is determined by the potential returns that can be demonstrated and a subjective assessment of other factors of merit. The region generating disposals does not have any prior call on those funds in its investment programme.

9.14. Reinvestment of the sale proceeds of non-operational land and buildings into other assets must meet Government-defined investment returns (currently 8 per cent in real terms). This is a very high level of return in present market conditions and the adoption of this threshold is likely to reduce severely the number of development projects that pass the test.

Case studies and reviews

9.15. We have examined the role that BWB has taken in a number of development projects and we have sought to establish, in particular, whether it had:

- acted as a facilitator; and
- not assumed significant development risk.

Improvements in asset value and reduction in liability are also important considerations. The three case studies we have undertaken are of:

- (a) the Stanley Ferry development near Wakefield in Yorkshire;
- (b) the Bulls Bridge development in the London Borough of Hounslow; and
- (c) the building of BWB's new headquarters at Willow Grange, Watford.

We have also reviewed the Limehouse Basin (in the London Docklands) and the Leeds Canal Basin projects. These are summarized in paragraphs 9.57 to 9.69 and described in more detail in Appendices 9.1 and 9.2.

The Stanley Ferry development

9.16. The Stanley Ferry site covers 5.7 acres where the Aire & Calder Canal spans the River just north of Wakefield (Figure 9.1). In the early 1980s the site was derelict: the waterway walls and tow-paths had been neglected and the open spaces were wild and overgrown. One of the main features, a mooring basin, needed extensive repair. The buildings were also in an advanced state of disrepair. A warehouse was falling down (see Figure 9.2). The former tollhouse, whose roof had collapsed and which was otherwise in urgent need of restoration, was a listed building which would have attracted a statutory repair notice (see Figure 9.2). These represented liabilities. There was also a ruined air-

raid shelter. The Stanley Ferry Aqueduct, an adjacent ancient monument owned and operated by BWB, was inaccessible by land. Figure 9.1 shows the main features and future planned developments of the site.

9.17. The leisure development opportunity was first identified in the mid-1980s. Until then the site had been used intermittently by a tenant for the open storage of coal, with some associated waterway transport. Negotiations were under way with the existing occupier for a new five-year lease which would have commenced in March 1984 and generated a rent rising to a maximum of £[*] a year. Agreement was not reached, partly because of planning problems limiting the amount of coal which could be taken to and from the site by road and partly because the tenant had set up an operation close to the centre of Wakefield.

9.18. While BWB continued to try to relet the site for freight purposes, the Estates Department started to explore how the site might best be exploited for alternative uses. Discussions with the Local Planning Authority were initiated by BWB and support was given, in principle, to the development of a marina for pleasure boats, notwithstanding that the property was, and still is, situated within a green belt area.

9.19. At the time there was little commercial interest and press advertisements resulted in only two serious enquiries. One was mainly for boat building and repairs and the second (which was eventually converted to a letting) was for a marina development which would also include a pub/restaurant and small hotel.

9.20. BWB had considered three options:

- (a) The first was to leave the site derelict until a freight business interest arose. This was not attractive. In BWB's experience, freight requirements specifically matching the attributes of the particular site rarely, if ever, arose. Any potential freight operator was unlikely to have been willing to accept the obligations in respect of the listed building and the improvement of the derelict warehouse. Based on these factors and BWB's previous financial experience of the use of the site for freight, the prospective rent was not expected to match that achievable from alternative uses which could benefit the property as a whole.
- (b) The second option was to complete an agreement with the boat repairer/boat builder who had expressed interest. There was, however, little likelihood that he would make a significant capital investment in the restoration of the site, and the covenants he was prepared to enter into were less satisfactory than those finally agreed.
- (c) The third option was to lease the site to the leisure developer (Developer A). This seemed the most attractive since it would provide a significant investment in BWB's property as well as an important new leisure opportunity for both boaters and the public at large. The developer had commissioned an appraisal of the site from a firm of chartered surveyors which, although equivocal in terms of its view of the likely success of the enterprise, did not condemn the proposal out of hand. The likelihood of success was enhanced by the prospect, on the basis of BWB's lease, of financial backing from a large brewer. BWB felt that even if the business failed the asset which it would inherit would be superior to that which it originally leased.

9.21. BWB did not consider sale of the site a serious option. It decided that freehold disposal was inappropriate because a substantial mooring basin formed part of the site and retention of ownership would allow control of the development.

9.22. Having selected the third option, negotiations commenced with Developer A. The project was managed for BWB by a member of the Regional Commercial Department at Leeds with assistance from the Regional Engineers and some input from BWB's Architectural Department based at Hillmorton, near Rugby. BWB officials spent a considerable amount of time with the developer settling the funding and planning problems. A major consideration was the protection and enhancement of the special heritage and environmental features of the site.

*Figure omitted. See note on page iv.

FIGURE 9.1

The Stanley Ferry development, actual and planned (tinted)



Source: BWR.

Notes:

1. Further extension.
2. Existing park and former warehouse.
3. Against garden gateposts.

FIGURE 9.2

Views of Stanley Ferry site before development



Source: BWB.

9.23. A number of problems arose during the early negotiations, not least some doubts about the financial status of the developer. It was decided to proceed, however, because there was no other serious interest in the site and, should there be any default on the lease, BWB's property would almost certainly end up in a much improved state.

9.24. [

*Details omitted.
See note on page iv.*

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9.25. During the two years or so that Developer A occupied the site, it had carried out a significant amount of work. It had completed the renovation of the warehouse and started on the restoration of the listed building. It was trading reasonably well in the pub, restaurant and marina. The scale of the operation, however, was relatively small in relation to the size of the site. On 3 April 1990 a Receiver was appointed. The principal reason appears to have been that the brewer, who held a charge on the lease but not on the property, was owed about £250,000. Developer A's financial problems appeared to come from his other business interests and not to be directly related to the Stanley Ferry development. As usual in such cases, the Receiver paid all outstanding sums of money to BWB, as landlord, because the only significant asset of the development company was the property and breach of the lease would entail loss of that asset.

9.26. The Receiver appointed a firm of surveyors to market its leasehold interest in the property and shortly afterwards the firm introduced BWB to a new prospective lessee. The Receiver, as tenant, would shortly have been in breach of some of the development covenants, which could have led to forfeiture of the lease. It was deemed to be in all the parties' best interests to negotiate a surrender of the existing agreement and enter into a new lease.

9.27. Developer B was researched by BWB before negotiations were entered into and in turn commissioned an independent report from a firm of surveyors. Whilst the original aims of the development remained the same, a number of detailed changes were eventually embodied in a new leasehold agreement. Developer B had attracted significant brewery and bank funding and BWB decided to increase its stake in the venture, over and above the existing site value, by investing £[*] in exchange for an increase in the rent payable by the tenant. This capital injection would directly assist in the completion of the next phase of the project and also help the developer attract other funding. BWB's approach remained cautious.

*Figure omitted. See note on page iv.

9.28. The general terms offered to Developer B were not dissimilar to those of the original lease, although the rent was increased from [*] to recompense adequately BWB's capital investment. The development covenants had a revised time-scale and were more detailed. In addition to protecting its interests through the lease, BWB ensured that the brewery and bank funding was handed over at the same time as the BWB cheque for £150,000. As an extra precaution BWB took a personal guarantee from the principal director of the development company and his wife. This agreement was completed in October 1990, although the tenant had actually been in occupation as licensee for some months previously.

9.29. At the beginning of 1991, the directors of Developer B called in the Receiver. As before, all rents owing to BWB were paid immediately. Although BWB believed it was well protected financially, in view of its capital investment, it had its Building Section carry out an immediate survey which established that a sum in excess of BWB's investment had been spent on the property. At the same time an independent valuation report showed that the rent charged at the time (£[*] a year) was well covered by the property value. In addition to the work done by Developer A, the refurbishment of the listed building and the refitting of the mooring basin had been completed, and alterations to the pub/restaurant were well under way.

9.30. The major creditors of Developer B were the brewer and the bank who were owed, we were told, over £500,000. The Receiver appointed a firm of surveyors to market the interest in the property. A third developer (Developer C) was obtained through the efforts of the brewer who also bought out the bank debt to gain controlling interest of the business development.

9.31. Although the recession was by now badly affecting this type of leisure property, business on the site had grown to such an extent that BWB was able to attract the interest of an experienced operator, and negotiations commenced on the present leasehold agreement with Developer C. The new lease was entered into in July 1991.

The project now

9.32. The objectives have remained unchanged, but the emphasis is now on the pub/restaurant and creating a family atmosphere. Developer C has traded satisfactorily and has so far invested approximately £[*] in the site. Work completed to date includes:

- (a) complete restoration and renovation of the listed tollhouse (see Figure 9.3);
- (b) conversion of the air-raid shelter into a chandlery;
- (c) fitting out of the moorings basin with floating pontoons;
- (d) conversion of the derelict warehouse into a well-equipped public house with extensive catering facilities (see Figure 9.3);
- (e) erection of a substantial conservatory effectively doubling the size of the original building (see Figure 9.3);
- (f) provision of a large low-level car park together with access road;
- (g) construction of a children's 'bar', with ancillary play area; and
- (h) provision of site security.

Access to the ancient monument has also been restored. The next stage will be the erection of a function room and, in due course, a hotel.

*Figures omitted. See note on page iv.

FIGURE 9.3

Views of Stanley Ferry site after development



Source: BWB.

Evaluation

9.33. BWB measures its expected return on its interest in this development as the gross yield. As part of its normal asset valuation exercise in 1988, BWB's property consultants valued its interest in the Stanley Ferry site. Notwithstanding the fact that BWB had secured a developer, the highly speculative nature of the venture meant that the valuation was only £[*]. In 1993 an external consultant valued BWB's interest at £[*] which, at an annual rental of £[*], is showing an [*] per cent yield. Despite the serious recession, BWB's land value investment of £[*] and allowing for its capital injection of £[*], BWB's interest in the site has shown a growth in value of over [*] per cent since 1988. In revenue terms a site that was earning no income in the early 1980s is now generating a minimum of £[*] annually as well as some £[*] to £[*] revenue from additional boat licences. BWB has also transferred its capital liabilities for the buildings on the site to the developer.

The Bulls Bridge development

9.34. The Bulls Bridge site is situated at the junction of the Paddington Arm with the main line of the Grand Union Canal at Hounslow (see Figure 9.4). The site covers approximately 14.6 acres. In 1988 the main site (on the south side of the canal) which was being considered for redevelopment was already an industrial development divided into five holdings. One was used by BWB itself as a repair yard. Head leases for land and buildings had been granted by BWB on the other holdings to four companies: A, B, C and D (Figure 9.4). These holdings were all sublet. Company A had two tenants, one of whom rented the moorings included in Company A's lease.

9.35. The project was initiated in 1988 when Company A approached BWB for consent to a redevelopment of its holding. BWB felt that this might pre-empt the potential for the site as a whole, and retained a consultant to advise on strategy. Strong occupier interest was expressed by two companies for a new high-value use, so BWB decided to buy out Company A in order to preserve its option to manage the site as a single unit. In spring 1989 Company X made a provisional offer of £[*] for the whole site. BWB held discussions with all its tenants.

9.36. In spring 1990 the neighbouring London Borough of Hillingdon announced that it was inviting tenders for a competing site less than a mile from Bulls Bridge. This put pressure on BWB because Company X made it plain that, if it could not get the Bulls Bridge site with the necessary planning permission, it would opt for the competing site rather than lose it to a competitor. In April 1991 the London Borough of Hounslow announced that it too was prepared to make a nearby competing site available to the north of the Bulls Bridge site.

Agreements and transactions

9.37. The surrender of Company A's industrial property head lease was obtained for £[*] in 1990, with a further £[*] also being paid to subtenants to gain vacant possession. BWB's property consultants confirmed that £[*] was the estimated market value of the leasehold interest. By 1991 the market value of BWB's interest had fallen to an estimated £[*], but had Company A known of Company X's interest in it, and its subtenants, could perhaps have achieved higher compensation. The timely purchase of Company A's head lease proved valuable to BWB.

9.38. [

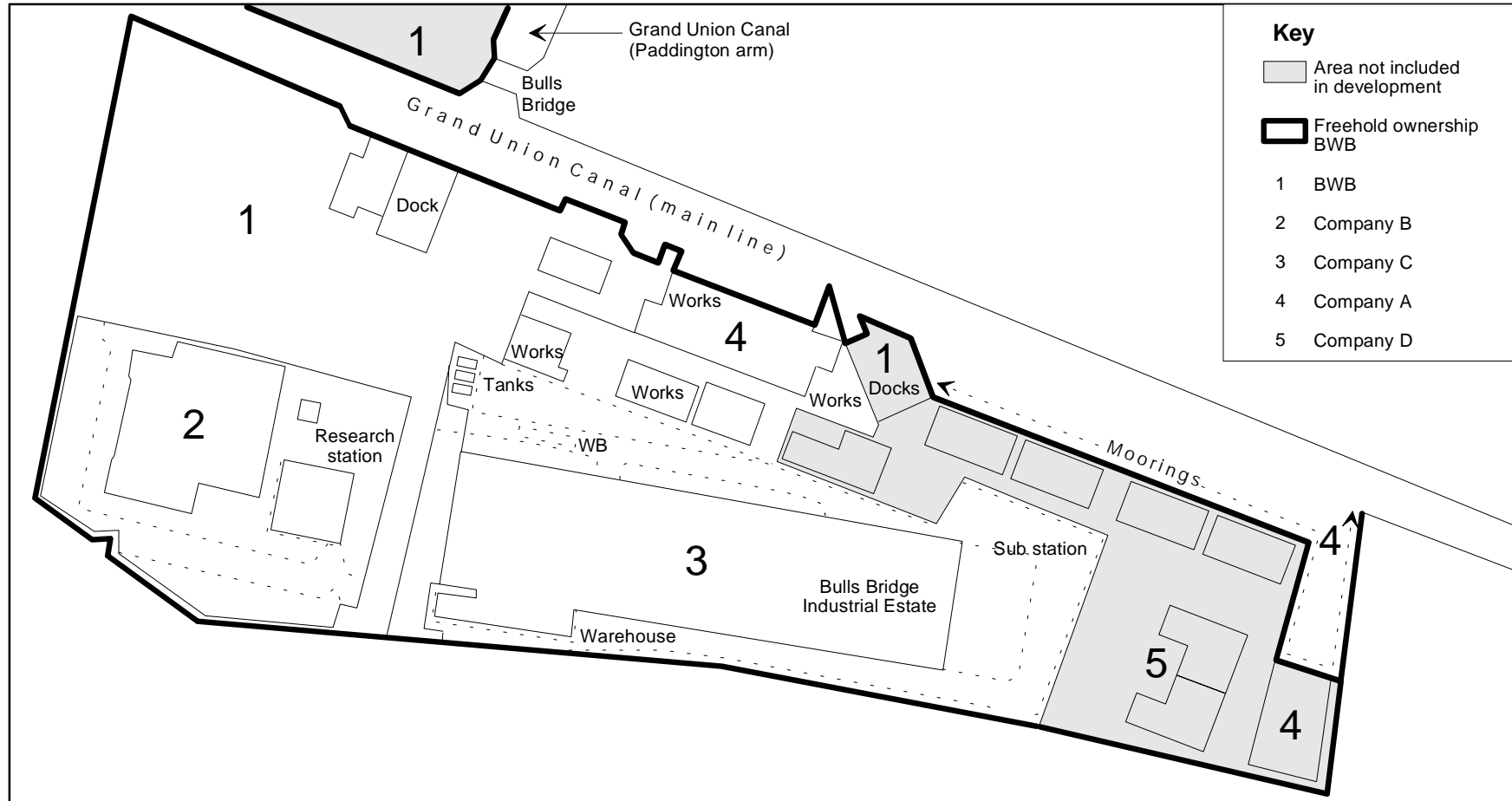
*Details omitted.
See note on page iv.*

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*Figures omitted. See note on page iv.

FIGURE 9.4

Bulls Bridge site showing original holdings



Source: BWB.

Note: This diagram is for illustration only. It has no legal or commercial significance.

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Details omitted. See note on page iv.

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9.39. The contracts between Company X, BWB, and Companies B and C were signed on 13 September 1991, the day that Hillingdon was accepting tenders for its site. The contracts would have conditions, such as requiring BWB to deliver the property without right of way across it. Consents from subtenants were needed to vary the terms of the leases and, in Company C's case, to get the subtenant to quit. Completion of the principal agreements was delayed to gain planning permission. At the end of 1991, BWB moved to acquire the marina interests from Company A and its subtenant. At the same time DoE inspectors had to examine the proposals and the DOT wished to give consideration to their implications for major roads in the area.

9.40. Company D refused to surrender its lease or agree to losing its right of way. It did agree, however, to vary the right of way in return for being able to acquire the reversionary interest for £[*], provided BWB paid the costs to gain the consent of subtenants. These costs were expected at the time to be no more than £[*]. BWB's consultants advised that the market value of BWB's reversionary interest was £[*]. Thus BWB was giving up an asset worth £[*] and paying subtenant costs in order to secure the main deal with Company X on the original terms. In October 1992 BWB agreed to sell to Company D the freehold of its holding for a nominal sum and on 25 March 1993 the sale of the site to Company X became unconditional. Completion was expected to take place in early August 1993.

9.41. At the end of 1991 BWB, on the advice of their property consultants, paid Company A £[*] for the surrender of its moorings and marine yard non-industrial lease. Shortly afterwards BWB paid the tenant £[*] for its subleases to boat owners. These transactions were motivated by the wish to:

- (a) take control of and generate income from residential mooring activities;
- (b) exploit the development potential; and
- (c) have free use of the previous operational land and buildings.

BWB's consultants confirmed that all transactions were at market values.

Evaluation

9.42. The financial outcome is summarized in Table 9.3.

TABLE 9.3 **Financial assessment of the Bulls Bridge project**

	<i>Losses/costs</i>	<i>Gains/benefits</i>
1. Net receipts of sale of site freehold		
2. Value of BWB's remaining assets on site		
3. Value of site to BWB in 1988		
4. BWB's other costs		
Totals		

£'000

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*Figures omitted.
See note on page iv.*

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Source: MMC study of BWB material.

We estimated that BWB has gained additional value of £2.14 million from the disposal of the Bulls Bridge site. BWB's own estimate is £3.223 million. BWB has also obtained infrastructure improvements-including 1,000 metres of new bank piling, new moorings, landscaping and environmental enhancement (which it estimates to be worth £500,000)-and now owns and operates the moorings and marina yard. It has also transferred responsibility for the site and the associated costs to Company X. If BWB had not made an initial investment (see paragraph 9.38) it is possible that no additional value or benefits would have been received.

*Figures omitted. See note on page iv.

The development of Willow Grange

9.43. In 1987 BWB decided to locate its headquarters at one place and to centralize at Watford. This case study examines how it was done and assesses the outcome.

Background

9.44. In 1986 BWB's Head Office functions were dispersed among seven different sites in central London, Watford and Rickmansworth. Staff savings and greater efficiency were envisaged from combining headquarters staff on one site, as recommended in the 1987 MMC report.

9.45. Since the early 1980s BWB had been seeking DoE approval for co-location, and its preferred site was Willow Grange, Watford. BWB had held the freehold of this site since the break-up of the BTC and the buildings and land had the potential, through redevelopment, to provide the space it needed. A consultant's report in 1986 supported BWB management's analysis and concluded that the Board should consolidate headquarters at Willow Grange. Our 1987 report (paragraph 10.47) also confirmed the importance of centralizing headquarters functions and shortly afterwards BWB put a new proposal and an extensive justification to the DoE.

9.46. The reorganization of BWB had the effect of reducing planned Head Office and engineering staff numbers from 318 to around 252. The original plan was to locate the 39 South East Region staff at Willow Grange as well but they actually took separate offices in Hemel Hempstead. Co-location was expected to reduce numbers still further to about 240 in all. Two-thirds of these were already living in the Watford area.

9.47. BWB's proposals were based on an assessment of alternative solutions to its accommodation problem and the need to rationalize its Head Office functions. The alternatives were compared with the option of remaining in existing premises as far as possible. The options considered were:

- retain existing locations;
- consolidate into central London and Willow Grange;
- redevelop Willow Grange as a single headquarters;
- build, or purchase, elsewhere in Watford;
- rent in Watford; and
- rent away from the South-East.

The assessments took into account the varying costs of property in different parts of the country and the likely costs of relocation, redundancy and new local recruitment. The least cost option, in NPV terms, ie to redevelop Willow Grange as a single headquarters, was chosen.

9.48. The BWB appraisals also explored the sensitivity of the present values of the costs to:

- different test discount rates (5 and 8 per cent);
- varying staff costs associated with relocation;
- increased building costs by up to 15 per cent;
- lower rental costs by as much as 15 per cent; and
- longer lives for new buildings.

Apart from the options of building, purchasing or renting at a new site in Watford, the discounted costs showed little spread, though the option to redevelop at Willow Grange generally had the most favourable (ie lowest cost) outcome. BWB used outside consultants to provide the building costs and property values, and such Government guidance as was available for evaluating projects at the time.

The sequence of events

9.49. The main stages of the project and the decisions taken are set out below. Most of the events described relate to the development of Willow Grange, but from August 1989 onwards there are also references to the Greycaine Road site. The Greycaine site was needed for temporary accommodation due to the delays on the Willow Grange development and BWB's need to vacate its London accommodation.

1986 May	Full appraisal of the Willow Grange proposal is sent to DoE.
	DoE proposes Willow Grange be the subject of a consultants' Value for Money Report.
December	Consultants' report completed. BWB sends a revised appraisal to DoE.
1987 March	Meeting between DoE and BWB to discuss proposal.
May	MMC report recommending co-location of headquarters staff.
June	BWB presents a revised proposal to DoE.
1988 March	DoE approves Willow Grange (cost £4.67 million) subject to the proposed reorganization and finalized headquarters numbers. Project Team formed.
May	Meeting with Watford BC Planning Dept raises doubts about scope of authority.
June	Planning Permission applied for.
December	Agreement of brief for architect. Building specification changed to maximize site potential (55,000 sq ft at a cost of over £9 million).
1989 February	Planning Permission obtained.
April 1989	BWB asks DoE to confirm consent of March 1988 now conditions have been met.
May	DoE asks BWB to consider further options for relocation and to get independent advice on costs and rents.
July	DoE asks for the latest appraisal to be put into a new free-standing document.
August	Opportunity arises to take temporary accommodation in Greycaine Road.
September	BWB puts revised proposal to DoE.
November	BWB signs and seals leases for Greycaine Road.
1990 January	DoE advises BWB to go ahead with Willow Grange but to revert when construction tender bids are in.
February	DoE queries whether Greycaine Road would be suitable as a permanent headquarters.
March	BWB sets out the situation with the existing property. DoE 'assumes' leases did not fall outside the authority of the Board: asks BWB to confirm expected rental levels for surplus space.
April	DoE and BWB correspond on whether Greycaine Road affects the merits of the Willow Grange case.
July	Tender bid opening.
August	Relocation to Greycaine Road. BWB sends DoE updated proposal.
September	DoE confirms approval to BWB. Building budget £9.441 million.
November	Site work starts at Willow Grange.

1992 March	Fixed price revision agreed with the building contractor.
June	Practical completion.
July	Relocation starts from Greycaine Road.

Approval and management

9.50. A project of this scale (ie in the event greater than £5 million) required BWB to gain the consent of the DoE and, through the Department, the Treasury, as well as requiring Board approval at all important stages. The DoE's assessment of BWB's proposals concentrated on ensuring that the analysis was well founded and that commercial judgments on such matters as staff costs, regional differentials and future land values seemed sound. Special arrangements were needed to fund a project of this size. The process of probing the analysis and confirming financing took considerable time, though BWB's responses to the DoE's questions were generally prompt.

9.51. This was one of the biggest projects ever before the BWB Board. The costs had increased from around £4.7 million to over £9 million for a larger building in the course of two or three years. The increased cost was largely due to the extra size of the building (55,000 sq ft instead of 30,000 sq ft) which BWB decided was needed to maximize income from the site. As BWB had no prospective tenants for the space it intended to let, this decision introduced a significant speculative element into the project. There is no Board minute formally recording approval of the final project or its various revisions. The Board simply 'noted' frequent progress reports and, from time to time, updates of the project. Formal requests for approval of the project were not put to the Board. The DoE, for its part, understood that the Willow Grange proposal had had the formal approval of the Board.

9.52. The procedures followed for securing temporary accommodation at Greycaine Road were the appointment of external agents to search for suitable property as it was important to get on with the restructuring of the business and BWB was also being pushed out of some of its current offices by its landlords. It was not clear at that stage that Willow Grange would be formally approved. In November 1989 BWB leased temporary accommodation of some 30,000 sq ft at Greycaine Road, Watford, pending the completion of Willow Grange. This was let to BWB on three leases: one with a breakpoint in 1994, another in 2001 and a final one in 2014. On the advice of independent valuers, BWB expected to be able to dispose of these leases when no longer required so that if Willow Grange was approved BWB would not be overcommitted. The commitment, however, was substantial (£4.4 million) and needed Board approval if it were for capital investment or a finance lease. We have seen nothing to show that Board approval was formally sought. BWB argued that its financial regulations did not require leases that have provision for rent reviews to be treated as finance leases.

9.53. Following conditional approval of the Willow Grange proposal in March 1988, BWB set up a steering committee and project team for the Willow Grange development, under the leadership of the Director of Personnel. The project team, consisting of BWB managers, met regularly, though not necessarily always with the departmental director in attendance. From an early stage, outside quantity surveyors, architects and estate agents were retained to provide independent advice and additional capability to do detailed work.

9.54. A small BWB group closely supervised the construction, with considerable involvement of the new Engineering Director who at that stage had taken over as project leader. The construction was managed effectively and, as a result of careful and detailed advance planning by the BWB group, the redevelopment was accomplished very close to final budget, and only three weeks behind schedule. Cost monitoring and control were effective, and invoice approval and authorities for payment were properly established and documented.

Evaluation

9.55. By May 1986 appraisal of the original Willow Grange project had been undertaken by consultants and sent to the DoE. The project was to provide around 50,000 sq ft of space for BWB staff alone. A revised proposal for 35,000 sq ft was approved by the DoE in March 1988, and was costed at £4.67 million (1988 values). The proposal was revised again in 1989 in order to maximize future returns from the site by

building 55,000 sq ft. Completion of the building occurred in June 1992, some six years after project initiation. The building, as constructed, provided 55,000 sq ft of space and was built at cost very close to the budget of £9.441 million (£6.84 million in 1988 values). Although the building size had increased by 57 per cent, costs (in real terms) were only 46 per cent higher.

9.56. There was a downturn in the property market between 1989 and 1991. By the time BWB came to seek tenants for the additional 15,000 sq ft of space in Willow Grange, levels of rental and demand for space had fallen sharply. The effects of this change in the market were:

- (a) BWB was unable to find tenants for the 15,000 sq ft of additional space at Willow Grange, constructed at a cost of £4.77 million (£2.17 at real 1988 prices).
- (b) BWB was unable to find tenants for the building at Greycaine Road (after moving from there to Willow Grange) and the annual rental cost is £486,000 plus business rates until September 1994 when it is reduced by one-third on the exercising of a break clause on one of the units.
- (c) BWB received approximately £0.4 million less than had been built into the financial appraisal for the surrender of a central London lease (given up as part of the co-location moves to Willow Grange) than had been expected and had been built into the appraisal of the larger building.

The Limehouse and Leeds Canal Basin projects

The Limehouse project

9.57. BWB first started to consider the development of the Limehouse Basin in 1981. It received four proposals from interested developers. Two were considered promising and financial bids were invited from the companies concerned. On receipt of the bids, BWB chose the one it considered preferable from the point of view of both design and likely return.

9.58. The developer sought outline planning permission for its proposals, but the project was sensitive to local user groups and encountered strong opposition. Following a public inquiry, the Secretary of State granted outline planning permission in 1985. This provided for 436 houses and flats and 10,000 square metres of commercial and business space. Subsequent to outline planning permission being granted the London Docklands Development Corporation (LDDC) announced its intention to construct a tunnel under the northern section of Limehouse Basin. This effectively reduced the area available in the medium term for development to 5.8 acres of land on the southern side of the basin. A further detailed planning application was submitted in June 1987, and permission was granted for 18,500 square metres of office space, 3,716 square metres of commercial and leisure accommodation and some 600 residential units.

9.59. The timetable envisaged the completion of the first phase of development by June 1990. In the event DoE and Treasury approval for BWB's investment was some eight months delayed (until May 1988).

9.60. A joint development company, Limehouse Developments Ltd (LDL), was formed between BWB and the developer. BWB's initial commitment to LDL was £5,000 in share capital and £975,000 in loans. This gave BWB a 49 per cent interest in the project. The balance of funds required was an estimated £8 million, to be raised from external sources. The total capital commitment of the two partners had to be increased as with changing market conditions banks were unwilling to provide as large a share of the funding as had been anticipated. In the event the partners had to invest a total of £4.5 million, of which BWB's share was £2.185 million.

9.61. LDL's accounts to 30 September 1992 showed capital and reserves of -£3.259 million. BWB made provisions against loans of £1.793 million in 1991/92 (against capital reserves) and of £0.392 million in 1992/93 (against profit and loss account).

9.62. BWB told us that LDL may not exercise its option on the remaining phases of the development on the due date of March 1994. BWB also told us that it has received a total of £1.555 million, in cash or in kind, from LDL. In addition it received a contribution of £1.25 million towards the cost of a new lock from LDDC and £92,000 from the Cruising Association.

9.63. A more detailed account of the project is provided in Appendix 9.1.

The Leeds Canal Basin project

9.64. In the first quarter of 1987 BWB and a developer formed a joint venture company, Leeds Canal Basin (Development) Limited (LCBD). The developer had already purchased, in June 1973, a 99-year lease from BWB on the Leeds Canal Basin land, but BWB still held the freehold. The site included a listed building with a substantial repair liability.

9.65. LCBD's initial objective was to develop the site as a whole. BWB told us that their objectives were to see this strategic, but derelict, waterway site developed in a way that released the best value but would also be sensitively integrated with the waterway. The estimated capital cost of the originally proposed development was £1.442 million and finance was to be provided from a cash injection of £450,000 by BWB (its share of the joint venture capital) and the developer's bank overdraft.

9.66. Planning permission was obtained in 1988, but the original plan was shelved. Further discussions between BWB and the developer led to a restructuring of LCBD at the end of 1991 to include an interest the developer held in an adjoining property. BWB remained with 49 per cent, and the developer 51 per cent, of the restructured company.

9.67. A financial appraisal in 1991 of the restructuring put the value of LCBD at £3.586 million and calculated an internal rate of return of just over 8 per cent. This assessment is highly sensitive to the assessed value of the LCBD land holding, as would be expected. A small part of the site together with the listed warehouse (and hence the liability for its repair) were disposed of to a second developer.

9.68. A more detailed account of the project is provided in Appendix 9.2.

Evaluation of the two projects

9.69. Both the Limehouse and the Leeds Canal Basin developments were joint ventures with companies in the private sector. In each case BWB held its maximum permitted 49 per cent share in the venture, which gave it limited influence but still left it with high risk. We have not attempted to assess the overall profitability of these schemes, but we note that:

- (a) Provisions have been made in respect of loans to LDL.
- (b) The value of LCBD land currently attributable to BWB as joint venture partner is £1.379 million, while BWB's contribution to the venture has totalled £1.335 million. This yields a modest surplus that may be increased by the realization of further development value relating to the railway arches part of the site. The disposal of the warehouse repair liability has also to be taken into account.
- (c) Some transactions have been 'in kind' and not all are recorded in BWB's books; returns from these projects may therefore be under-reported in the annual accounts.

It is important when BWB reappraises the projects that its investments in both cash and kind should be taken into account. It is too early to assess these joint ventures fully as much depends on the value of land still held and on developments in the property market.

Conclusions and recommendations

Management investment portfolio

9.70. Out of some 7,000 non-operational properties in the estate portfolio BWB has identified approximately 600 as having development potential, and within this there are some 200 for which plans already exist or are contemplated. On a strict interpretation of the Treasury Guidelines the test discount rate of 8 per cent may not be met. However, we have been assured by the DoE that, in practice, other considerations can be taken into account. Having regard to the heritage and environmental duties laid upon BWB we conclude that the development of these properties is integral to the future of the waterways.

9.71. We recommend that BWB continue to plan for the development of its identified properties and, while exercising its usual care, the DoE looks at such plans sympathetically.

9.72. BWB is not a statutory consultee in local authority planning applications concerning land it does not own which adjoins its waterways. Developments close to waterways can increase significantly BWB's liabilities for water containment and safety, resulting in extra expenditure without any obligations on the part of the developer to contribute. We conclude that unless BWB becomes a statutory consultee in planning applications for sites adjacent to its waterways, the present unsatisfactory situation will continue.

9.73. We recommend that BWB should be a statutory consultee in local authority planning applications for sites which are sufficiently near to the waterways to require further specific works to guarantee the safety of the site and/or restrictions on the site development to guarantee the safety of the waterway concerned. BWB should be empowered to require that the developer bears the cost of the necessary works and maintenance identified by BWB.

Case studies and reviews

9.74. We have carried out three case studies (Stanley Ferry, Bulls Bridge and Willow Grange) and reviewed two other major developments (Limehouse and Leeds Canal Basin), and have assessed them against the criteria set out in paragraph 9.15. We conclude that:

- (a) BWB has acted as an effective facilitator of development in all five cases.
- (b) BWB has assumed significant development risk in three of the cases. In the Limehouse and Leeds projects it invested substantial sums and took a 49 per cent equity share in the development; at Willow Grange it acted as sole developer (as well as freeholder) and in effect entered the speculative property market on its own account; as a result it has not in these cases maximized the returns on the funds invested.
- (c) It is too early to say what returns BWB may achieve from these projects and what increases in net asset value may finally be attained.
- (d) Appraisals of some projects (notably Limehouse, Leeds Canal Basin and Willow Grange) have shown an excessive optimism in their focus on possible large development gains.
- (e) The true costs and benefits of the joint ventures are difficult to assess because of payments in kind that are not reflected in BWB's accounts.

9.75. We recommend that BWB should avoid taking a significant share in development risk and hence in the funding of developments, restricting its role (as in the case of Stanley Ferry) mainly to acting as facilitator.

9.76. We also have a number of conclusions and recommendations specific to individual projects.

Stanley Ferry

9.77. We are generally content with the way BWB has sought to develop the site at Stanley Ferry. It has acted throughout with a high degree of professionalism aimed, on the one hand, at raising the value of the site and generating income from it and, on the other hand, at achieving significant environmental improvement and the restoration of a listed building. This fits BWB's proper role as a facilitator, using its skills and expertise in waterway developments in the context of its wider-ranging public responsibilities. It should continue as far as possible to leave risk-taking to its commercial partners whose proper entrepreneurial function it is. BWB now needs to estimate its expected return from the development.

Bulls Bridge

9.78. The Bulls Bridge project has been a success. BWB gained some £2 million from the sale of the site and has transferred costs associated with the site to the purchaser. It has also retained the right to oversail the canal, and now owns and operates moorings and a marina yard at the site.

Willow Grange

9.79. While the building phase was implemented to time, there were delays in the execution of the project as a whole-though it is not clear to us how far this was due to the conduct of BWB as opposed to Government departments.

9.80. The expansion of the project to include a speculative element was not assessed with sufficient attention to the risks arising from changes in the property market.

9.81. There was an excessive degree of informality in the way the Board approved the project.

9.82. Financial controls on taking on property leases were inadequate.

9.83. In respect of the conclusions in paragraphs 9.80 and 9.81 respectively, we recommend that appraisal of property projects should include all of their aspects and:

- (a) both the original project and any substantial changes should be fully discussed and formally approved by the Board, and such decisions should be fully recorded in Board minutes even when final authorization of the project rests with the DoE; and
- (b) financial controls on leases should be similar to those on other commitments of comparable size.

Limehouse and Leeds Canal Basin projects

9.84. The Limehouse and Leeds Canal Basin projects are joint ventures in which BWB has a 49 per cent share. In each case it has provided substantial funds which now appear to be in jeopardy. We doubt whether in making these arrangements BWB took fully into account the risks involved if the developments did not go according to plan. We understand that with the benefit of hindsight BWB would not enter into further joint ventures of this kind.